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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

MAX SWIREN

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Seventh Circuit entered in this case on July 14, 1950.

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 81-89) are not officially reported. The opinion of the Court of Appeals (R. 98-103) and the dissenting opinion of Judge Kerner (R. 103-104) are reported at 183 F. 2d 656.

JURISDICTION

The judgment of the Court of Appeals was entered on July 14, 1950. (R. 105.) On October 10, 1950, the Chief Justice granted an extension of time until December 11, 1950, within which a petition for a writ of certiorari might be filed (R. 106). The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254 (1).

QUESTION PRESENTED

The taxpayer was a member of a partnership engaged in the practice of law. The taxpayer withdrew from the firm, the partnership was dissolved, and the remaining partners formed a new firm. In withdrawing, the taxpayer sold his interest in the firm to the remaining partners. A substantial portion of the cash consideration received by the taxpayer from his former partners was attributable to his interest in fees earned by the old partnership but not yet collected.

The question is whether, to the extent that the taxpayer received a cash consideration for his interest in the uncollected fees earned by the old partnership, he is to be taxed with ordinary income, as the Tax Court held and as the Commissioner contends, or whether he is to be taxed with gain from the sale of a capital asset, as the Court of Appeals held.

STATUTE INVOLVED

The applicable provisions of the statute involved are set forth in Appendix A, *infra*, pp. 22-30.

STATEMENT

The undisputed, pertinent facts found by the Tax Court may be summarized as follows:

In February, 1932, the taxpayer became a partner in the law firm of Levinson, Becker, Gilbert, Peebles & Swiren, of Chicago, Illinois. Levinson was a retired partner, but his name was continued in the successor firms. At that time, the taxpayer purchased a ten percent capital interest in the firm from Becker for $10,000 in cash. In 1934, Gilbert retired from the firm. The taxpayer purchased one-half of Gilbert's interest for $14,750 in cash. This increased the taxpayer's interest in the firm by an additional ten percent. The remainder of Gilbert's interest was purchased by the other partners. The amounts paid to Gilbert were substantially in excess of his share of the aggregate of all the assets of the firm, including physical assets, accounts receivable, and fees earned. The name of the firm was changed to Levinson, Becker, Peebles & Swiren and the partnership continued to use that name until its dissolution on the taxpayer's withdrawal in 1944. (R. 81-82.)

The taxpayer, from time to time, purchased additional portions of their interests from his partners. By 1944, he had made an aggregate cash investment of $33,500 and had received a return on that investment in the total amount of $14,897.74. Accordingly, at the time when he withdrew, the taxpayer had a net capital investment of $18,602.26

in the firm and possessed a 30 percent interest, being entitled to that percentage of the net profits of the partnership. (R. 82.)

Shortly before the dissolution of the firm in December 1944, and as a basis for settling his interest, the taxpayer submitted a statement setting forth his determination of his partnership interest and his interest in the partnership assets. This statement showed the following (R. 83):

Firm equity—October 31, 1944.....	$ 15,628.00
Billed fees (excluding entirely all fees billed prior to January 1, 1944)....	12,800.00
Library--additional value.....	6,300.00
Leasehold improvement—additional value	1,500.00
Furniture and fixtures—additional value	3,000.00
Supplies	700.00
Unbilled fees (exclusive of Midland).	106,093.00
Deferred charge (Public Administrator contributions during this year)..	5,000.00
Taxpayer's valuation of partnership assets	$151,021.00
Less distribution to Ben Heineman, a junior partner.....	5,400.00
	$145,621.00
Taxpayer's 30% interest in the above total	$ 43,686.30

The firm equity, or net worth, shown above was taken from the firm's balance sheet as of October

31, 1944. The balance sheet, prepared on the cash basis, had omitted all uncollected fees, billed and unbilled, and also any amount for good-will. The additional values shown in the tabulation represented the taxpayer's estimate of the excess over book value, less depreciation. (R. 83.)

The taxpayer negotiated the sale of his interest exclusively with Becker. In arriving at the sale price, there was no explicit agreement or discussion concerning the value of any of the underlying assets of the partnership. (R. 83.)

The firm of Levinson, Becker, Peebles & Swiren was dissolved as of December 31, 1944, pursuant to a written agreement dated December 13, 1944. By the terms of the agreement, the taxpayer sold to Becker and Peebles all his share and interest in the firm, excepting only and excluding the "Midland fee." (R. 83-84.) The agreement specifically provided that taxpayer's share and interest in the firm being sold (R. 53, 84) "shall include his share and interest in the name and good will of the Firm, all furniture, fixtures, library, cash, fees earned whether or not billed, and accounts receivable, excluding, however, the Midland fee."

Under the agreement, Becker and Peebles were to pay the taxpayer a total cash consideration of $40,000, and agreed to assume all obligations of the firm. The taxpayer was also to receive certain physical equipment. (R. 84-85.) The Midland fee, when collected, was to be divided so that the

taxpayer would receive 25 percent for services rendered after the dissolution of the firm, and the remaining 75 percent, for services rendered by the firm up to that time, was to be divided among the partners of the old firm, including the taxpayer who was to receive 28.2 percent of this amount. (R. 53-55.)

In his return for 1944, in addition to his distributive share of the partnership earnings (accounted for by the firm on the cash basis) which was returned as ordinary income, the taxpayer treated his "Partnership interest in Levinson, Becker, Peebles and Swiren" as having been sold as a capital asset. He showed a selling price of $38,850, cost of $18,314.89, gain of $20,535.11, and taxable capital gain of $10,267.52. (R. 85.)

The Commissioner, in his deficiency notice, determined that the taxpayer realized ordinary income rather than capital gain in the transaction respecting the dissolution of the firm, and that such income was in the amount of $22,775.92. The Commissioner also filed an amended answer to the taxpayer's petition to the Tax Court in which an increased deficiency was asserted, it being alleged that the taxpayer realized ordinary income of $31,830.40 for his interest in billed and unbilled partnership fees. (R. 85-86.)

The Tax Court sustained the Commissioner's deficiency determination (except in a minor respect having no bearing on the present issue), hold-

ing that the taxpayer realized ordinary income to the extent that the consideration which he received was allocable to his share of the fees which had been earned but not yet billed or collected. Since the record contained no factual basis for making an allocation different from that on which the deficiency notice was based, the Tax Court sustained the Commissioner's deficiency determination but denied the increased deficiency asserted in the Commissioner's amended answer. (R. 86-89.)

The Court of Appeals, Judge Kerner dissenting, reversed (R. 98-104). It held that the taxpayer had sold a partnership interest, that this was taxable as the sale of a capital asset, and that the nature of the underlying partnership assets was immaterial.

REASONS FOR GRANTING THE WRIT

1. This case and *First National Bank of Mobile, Executor of the Estate of Aaron Lowenstein* v. *Commissioner,* No. 342, this Term, present related questions concerning the taxation of a deceased or withdrawing partner which are of considerable importance in the administration of the income tax law, which are the subject of conflicting views in the lower courts, and which have not previously been determined by this Court. In order that these critical issues may be finally settled by authoritative decision of this Court, the taxpayer's petition in No. 342, as it relates to one of the questions raised, is not being opposed, and this petition for a

writ of certiorari is being filed on behalf of the Commissioner of Internal Revenue.

A decision by this Court in these cases can remove a source of continuing confusion in matters subject to recurrent litigation. Subsequent to the denial of certiorari in *Commissioner* v. *Smith,* 338 U.S. 818, and *Commissioner* v. *Long,* 338 U.S. 818, both involving decisions of the Court of Appeals for the Fifth Circuit holding that a sale of a "partnership interest" is the sale of a capital asset, and guided by the oft repeated admonition that this Court, by the denial of a petition for a writ of certiorari, does not pass on the merits of a lower court's decision, the Government, in *United States* v. *Shapiro,* 178 F. 2d 459 (C.A. 8th), renewed the fundamental position which the Bureau of Internal Revenue had always taken, namely, that a partner who sells his interest in a dissolved partnership is only selling his proportionate interest in the firm assets, and that the nature of those assets is determinative of whether there is a realization either of ordinary income or of capital gain. The court there, while conceding that the Government's view was (p. 460) "not devoid of logic," stated that the denial of certiorari in *Commissioner* v. *Smith* and *Commissioner* v. *Long, supra* (p. 461) "indicates to us that the Supreme Court is not disposed to disturb the rulings" of the other Courts of Appeals "to the effect that the sale of

an interest in a partnership is the sale of a capital asset, regardless of the nature of the partnership properties." Accordingly, the *Shapiro* case rejected the Government's position.

The desire to avoid further litigation by the Government in the lower courts and the necessity of endeavoring to protect the interests of the revenue by putting to rest an arguable issue whose resolution either way sometimes redounds to the benefit of the taxpayer and sometimes to the benefit of the Government, induced the Chief Counsel, Bureau of Internal Revenue, to promulgate G.C.M. 26379, 1950-1 Cum. Bull. 58. See Appendix B, *infra*, pp. 30-32. In the absence of an authoritative pronouncement by this Court which would have furnished guidance, and in an attempt to achieve uniformity in the treatment of taxpayers which would accord with the decisions of the lower courts, the G.C.M. expressed the opinion that a sale of a "partnership interest" should be treated as a sale of a capital asset. To accord with the decisions in *Helvering* v. *Smith*, 90 F. 2d 590 (C.A. 2d), and *Doyle* v. *Commissioner*, 102 F. 2d 86 (C.A. 4th), it was further stated that "payments made to a retiring partner which represent his distributive share of earnings for past services should be treated as ordinary income rather than the proceeds derived from a sale of his interest."

The position taken by the Commissioner in the present case was in harmony with G.C.M. 26379. Since the taxpayer here, upon withdrawing from the partnership, was paid for his share of uncollected profits resulting from past services, the Commissioner ruled that to this extent he received ordinary income and should be taxed accordingly. The Tax Court, notwithstanding its decisions that a sale of a partnership interest results in capital gain or loss in other circumstances, upheld the Commissioner in the situation here. The court below, however, emphasizing the decisions of the Tax Court and of the other circuits holding that the sale of a partnership interest is the sale of a capital asset (with particular reliance on *United States* v. *Shapiro,* 178 F. 2d 459 (C.A. 8th), and its stress on the denial of certiorari in *Commissioner* v. *Smith* and *Commissioner* v. *Long, supra*) reversed the Tax Court and held that the income was to be taxed as capital gain. In so deciding, it refused to follow the decisions in *Helvering* v. *Smith,* 90 F. 2d 590 (C.A. 2d), and *Doyle* v. *Commissioner,* 102 F. 2d 86 (C.A. 4th), and ignored the portion of G.C.M. 26379, quoted above, which would have required a contrary result.

The decision below demonstrates why these issues cannot be set at rest by a mere administrative pronouncement which, at best, can only determine how the Bureau of Internal Revenue will apply the taxing statute in its administration

of the law. Since a particular court may refuse to apply a given aspect of the ruling, the Bureau is powerless to evolve a harmonious, workable rule, especially where, as here, the portion of the administrative ruling rejected by one court reflects the decisions of other Courts of Appeals. Since those courts, by following their own decisions, would have achieved a contrary result if the identical case had been presented for decision there, it is the considered view of the Government that only a decision on the merits by this Court can achieve a uniform rule which will be applied in all instances and in all circuits without the need for repeated litigation.

It is a problem of importance to taxpayers as well as to the Government that these matters be settled. This is illustrated by *First National Bank of Mobile, Executor of the Estate of Aaron Lowenstein* v. *Commissioner,* No. 342, this Term. There, the Commissioner took a position in the lower courts which is in harmony with the pronouncement of G.C.M. 26379. That is, since that case did not involve a payment on account of earnings for past services, the Commissioner contended that the loss which occurred on the death of a partner resulted from a sale of a partnership interest which should be taxed as a capital loss. That position, taken by the Commissioner in view of the existing decisions in the lower courts rather than because

of any conviction of its correctness,[1] was upheld by the Tax Court and by the Court of Appeals for the Fifth Circuit. Because of the statutory limit on deductions for capital losses, the decision there worked to the taxpayer's detriment.

The *Lowenstein* case makes it evident why, even though the Bureau of Internal Revenue attempts to harmonize its own administrative practice with the unreviewed decisions of some of the Courts of Appeals, it cannot thereby completely avoid litigation. Taxpayers, not being bound by such administrative rulings, are free to raise the issue whenever opposition to the rule would operate to their advantage. And, since there is a seeming conflict, at least in principle, between the *Lowenstein* case and decisions of other circuits and of the Court of Claims (see *infra*, pp. 13-16), and since all circuits have not yet decided the matter, repeated litigation by taxpayers cannot be avoided even though the Government should attempt, in accordance with G.C.M. 26379, to abide by the principle that, generally, the sale of a partnership interest is necessarily the sale of a capital asset.

---

[1] Should certiorari be granted in this case, the Government proposes to press the arguments it advanced in the *Smith* and *Long* petitions for certiorari, *supra*. It will argue, in any event, that if that basic position is not accepted, G. C. M. 26379 should be followed completely, with the result that the judgment below would be reversed on the ground that it is inconsistent with the exceptive principles announced in the third paragraph of G. C. M. 26379, Appendix B, *infra*, pp. 31-32.

While the present case, which involves a payment on account of earnings for past services, may be distinguishable from the *Lowenstein* case, there is an undeniable relationship between the problems presented, and a decision in the present case may reflect on the correctness of the decision in the *Lowenstein* case. The decision in the *Lowenstein* case is, moreover, opposed by the decision of the Court of Claims, in *City Bank Farmers Trust Co.* v. *United States,* 47 F. Supp. 98. Accordingly, for the reasons set forth in the memorandum being filed for the Commissioner in the *Lowenstein* case, the granting of the taxpayer's petition in that case, as it relates to the issue whether the sale of a partnership interest is the sale of a capital asset, is not being opposed.

2. The decision below conflicts with the decisions in *Helvering* v. *Smith,* 90 F. 2d 590 (C.A. 2d); *Doyle* v. *Commissioner,* 102 F. 2d 86 (C.A. 4th); and *City Bank Farmers Trust Co.* v. *United States,* 47 F. Supp. 98 (C. Cls.). See also *Bull* v. *United States,* 295 U.S. 247; *Neuberger* v. *Commissioner,* 311 U.S. 83. In *Helvering* v. *Smith, supra,* the taxpayer, as here, retired as a partner from a law firm and received a lump sum payment from the other partners who continued in a new partnership, the payment being in consideration of the retiring partner's interest in earnings which would be received after dissolution for services performed

prior to that time. The Court of Appeals there held that the taxpayer was to be taxed with the receipt of ordinary income and that he had not sold a capital asset. While the court below stated that *Helvering* v. *Smith*, *supra* (R. 102-103), "appears" to have been subsequently overruled, it was undeniably mistaken. For in *Commissioner* v. *Whitney*, 169 F. 2d 562, 567, fn. 5 (C.A. 2d), certiorari denied, 335 U.S. 882, which contains the most recent discussion of the *Smith* case by the Second Circuit, that case was cited with approval.

Nor is *Helvering* v. *Smith*, *supra*, to be put aside on the grounds urged by the taxpayer below, namely, that here the taxpayer had an investment in the firm, while none was present in the *Smith* case. The only effect of that difference has already been reflected in the Commissioner's deficiency determination and in the Tax Court's decision. That is, in determining how much net taxable income was received by the taxpayer, the amount of his investment was first deducted from the gross proceeds paid to him. Whether or not an investment is made when a taxpayer becomes a partner will affect the amount of income realized; it cannot determine the nature of what is sold when he ceases to be a partner or the character of the income received. To the extent that payment is received in relation to fees earned but not yet collected, the gain should be uniformly taxed either as ordinary income or as capital gain, unaffected by whether an investment was made. In that

ultimate respect, the *Smith* case cannot be reconciled with the decision here and the court below attempted no reconciliation.

Doyle v. *Commissioner*, 102 F. 2d 86 (C.A. 4th) reflects a like inconsistency with the decision below. There, a member of a dissolved partnership of attorneys transferred his proportionate interest in an uncollected fee (with respect to which the services had already been performed) to one of his former partners for a lump sum consideration. The court there, relying on *Helvering* v. *Smith*, *supra*, held that ordinary income had been received and that there had been no sale of a capital asset.

The *Doyle* case differs from the present one only in that there the dissolved partnership was being liquidated, with no new partnership being formed, and the taxpayer receiving a sum in lieu of what he might have been entitled to in the ordinary course of liquidation. In the present case, the assets of the dissolved firm were not liquidated and, instead, they were ultilized by those members of the dissolved firm who created a new partnership. What the taxpayer received here was in lieu of what he would have been entitled to receive if the parties had agreed that there should be a liquidation. These differences do not distinguish the cases or harmonize the conflicting principles which they apply. In both situations, the withdrawing partner has received a lump sum payment in lieu of liquidation rights

to fees for services previously rendered—rights which would have ripened into ordinary income if the fees had been collected in the process of liquidation. The nature of what was sold in either case must be the same; it cannot depend upon extraneous factors, i.e., whether, as in the *Doyle* case, there is only one purchaser to those rights, or, as here, there is more than one, or whether the purchasers associate together in a new partnership, as here, or the single purchaser embarks on his own law practice, as in the *Doyle* case.

Contrary in every respect to the decision below, the Court of Claims, in *City Bank Farmers Trust Co.* v. *United States*, 47 F. Supp. 98, held that in determining the applicable holding period of capital assets for tax purposes, a partner does not possess an interest in the firm which, of itself, is a capital asset capable of being sold, that the partners possess an interest in all the specific partnership assets which is all that is sold when an interest in a partnership is transferred, and that these matters are determined by the taxing statute and not by the provisions of local law respecting partnerships.

3. The decision below, of necessity, rejects the principle, announced in decisions of this Court and of other Courts of Appeals, that ordinary income is realized even though there is a commutation of rights to future payments, so long as these rights would have constituted ordinary in-

come when received. *Hort* v. *Commissioner*, 313 U.S. 28 (lump sum payment to lessor on cancellation of lease); *Burnet* v. *Harmel*, 287 U.S. 103 (bonus payment to lessor of oil and gas lease); *Shuster* v. *Helvering*, 121 F. 2d 643 (C.A. 2d) (lump sum settlement of right to future payments for past services); *Rhodes' Estate* v. *Commissioner*, 131 F. 2d 50 (C.A. 6th) (sale of right to dividends declared but not yet paid). See also *Cox* v. *Helvering*, 71 F. 2d 987 (C.A. D.C.) (payment for agreement by individual not to engage in a particular business).

By the same token, the doctrine that, for purposes of taxation, income cannot be disassociated from the source which created it is necessarily rejected by the court below. The decisions of this Court are uniform in holding that the person whose property or services create income cannot be relieved from taxation by an anticipatory transfer of the right to the income to another. *Lucas* v. *Earl*, 281 U.S. 111; *Douglas* v. *Willcuts*, 296 U.S. 1; *Helvering* v. *Clifford*, 309 U.S. 331; *Helvering* v. *Eubank*, 311 U.S. 122; *Helvering* v. *Horst*, 311 U.S. 112; *Harrison* v. *Schaffner*, 312 U.S. 579; *Commissioner* v. *Sunnen*, 333 U.S. 591. While those cases involved the selection of the proper taxpayer, they would similarly point to the conclusion that where, as here, personal services are responsible for the creation of rights to ordinary income, such rights cannot be disassociated from the personal services from

which they were derived or become transmuted into capital gain merely because they are anticipatorily sold to another.

4. These settled principles lose none of their vitality simply because the matter at hand relates to partnership transactions. The capital gains provisions embodied in Section 117 of the Code (Appendix A, *infra*, pp. 23-24) were designed as an exception to the general rule of taxing income in order to relieve taxpayers of the excessive burdens otherwise resulting from a conversion of capital assets. *Burnet* v. *Harmel*, 287 U.S. 103, 106. It seems reasonably plain that they were not intended to provide any exceptional treatment where there is an anticipation of rights to future income—income which, whether collected either during liquidation of the partnership or during its continuance, would have been taxable to the recipient as ordinary income.

The error of the court below is demonstrated by its reliance on the law of Illinois for the proposition that the taxpayer sold an interest in the partnership which (R. 102) "is property distinct and separate from the partnership or underlying assets." *Burnet* v. *Harmel, supra*, demonstrates that the taxing statute, not local law, determines whether what was sold was the kind of property which is a capital asset, and *Hort* v. *Commissioner*, 313 U.S. 28, demonstrates that, even though certain rights may be termed "prop-

erty" for some purposes, they are not necessarily "property" within the capital asset definition of Section 117 (a). Actually, the taxing statute contains its own definition of a partnership (Section 3797 (a)(2), Internal Revenue Code, Appendix A, *infra,* pp. 29-30) and its own scheme of taxing the partnership income to the individual partners rather than the partnership, the nature of the income always being dependent on the nature of the particular assets. Secs. 181-190, Internal Revenue Code (Appendix A, *infra,* pp. 25-29). The "property" rights of a partner, either during the continuance of the firm or upon its dissolution, must be determined in accordane with the priniples established by Congress and not by the varying concepts of local law respecting partnerships. The taxing statute, contrary to the decision below, recognizes no such concept as a "partnership interest," except as it relates to the partner's interest in specific partnership property. Section 113 (a)(13), Internal Revenue Code (Appendix A, *infra,* pp. 22-23); *City Bank Farmers Trust Co.* v. *United States,* 47 F. Supp. 98 (C. Cls.).

When the partnership in which the taxpayer was a member was dissolved pursuant to the mutual agreement of the parties, the taxpayer, no matter what may be true under state law, did not possess any interest in the defunct firm which was "property" within the meaning of Section 117 and which was a capital asset which he could sell to anyone else. In that respect, the situation is

the same as when an individual proprietor sells his "business" to another, the "business" not being regarded as property which is a capital asset. *Williams* v. *McGowan,* 152 F. 2d 570 (C.A. 2d). The taxpayer had a right to have the assets of the firm liquidated and to receive the proceeds, or he could, as here, sell those rights to anyone, including his former partners. In either situation, what he received must depend on the nature of the assets sold—it has nothing to do with a theoretical concept of a partnership interest.

It will be noted that the very agreement by which the taxpayer sold his interest in the dissolved partnership to his former partners explicitly stated (R. 53) that the interest being sold included the taxpayer's share of, among other things, "cash, fees earned whether or not billed, and accounts receivable", and that the Tax Court found (R. 86) that the consideration received by the taxpayer included a settlement, not only of his "proprietorship interest" in the firm, but also of "his claim to various fees which had been earned but not yet billed or collected." It is submitted that the court below was plainly wrong in holding that the taxpayer did not sell his interest in these fees and that he sold only his (R. 103) "partnership interest as a whole," that this was a capital asset, without regard to the nature of the partnership assets at the time of dissolution, and that the attendant gain was taxable only as capital gain.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

NOVEMBER, 1950.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(13) *Partnerships.*—If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any other paragraph of this subsection, then the basis shall be the same as it would be in the hands of the transferor,

increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

* * * * *

(26 U.S.C. 1946 ed., Sec. 113.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Section 115(b), Revenue Act of 1941, c. 412, 55 Stat. 687, and Section 151(a), Revenue Act of 1942, c. 619, 56 Stat. 798] *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), or an obligation of the United

States or any of its possessions, or of a State or Territory, or any political subdivision thereof, or of the District of Columbia, issued on or after March 1, 1941, on a discount basis and payable without interest at a fixed maturity date not exceeding one year from the date of issue, or real property used in the trade or business of the taxpayer.

* * * * *

(4) [As amended by Section 150(a), Revenue Act of 1942, *supra*] *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(b) [As amended by Section 150(c), Revenue Act of 1942, *supra*] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(26 U.S.C. 1946 ed., Sec. 117.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) [As amended by Section 150(g), Revenue Act of 1942, *supra*] As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) [As amended by Section 150(g), Revenue Act of 1942, *supra*] As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1946 ed., Sec. 182.)

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) [As amended by Section 9(c), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

(b) [As amended by Section 150(g), Revenue Act of 1942, *supra*] *Segregation of Items.*—

(1) *Capital Gains and Losses.*—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) *Ordinary Net Income or Loss.*—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) *Charitable Contributions.*—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by section 23(o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or

gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

(d) [As added by Section 9 (c), Individual Income Tax Act of 1944, *supra*] *Standard Deduction.*—In computing the net income of the partnership, the standard deduction provided in section 23 (aa) shall not be allowed.

(26 U.S.C. 1946 ed., Sec. 183.)

SEC. 184 [As amended by Section 126 (f), Revenue Act of 1942, *supra*]. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership. If the partnership elects under section 125 to treat the premium on bonds, the interest on which is allowable as a credit under section 25 (a) (1) or (2), as amortizable, for the purposes of the preceding sentence the partner's proportionate share of the interest received by the partnership shall be his proportionate share of such interest (determined without regard to this sentence) reduced by so much of the deduction under section 23 (v) as is attributable to such share.

(26 U.S.C. 1946 ed., Sec. 184.)

SEC. 186. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in section 131.

(26 U.S.C. 1946 ed., Sec. 186.)

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

(26 U.S.C. 1946 ed., Sec. 187.)

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for

any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner.

(26 U.S.C. 1946 ed., Sec. 188.)

SEC. 189 [As added by Section 211 (d), Revenue Act of 1939, c. 247, 53 Stat. 862]. NET OPERATING LOSSES.

The benefit of the deduction for net operating losses allowed by section 23 (s) shall not be allowed to a partnership but shall be allowed to the members of the partnership under regulations prescribed by the Commissioner with the approval of the Secretary.

(26 U.S.C. 1946 ed., Sec. 189.)

SEC. 190 [As added by Section 155 (h), Revenue Act of 1942, *supra*]. ALLOWANCE OF AMORTIZATION DEDUCTION.

In the case of emergency facilities of a partnership, the benefit of the deduction for amortization allowed by section 23 (t) shall not be allowed to the members of a partnership but shall be allowed to the partnership in the same manner and to the same extent as in the case of an individual.

(26 U.S.C. 1946 ed., Sec. 190.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U.S.C. 1946 ed., Sec. 3797.)

APPENDIX B

G. C. M. 26379, 1950-1 Cum. Bull. 58:

An opinion is requested whether, for Federal income tax purposes, the Bureau should continue to treat a sale of a partnership interest as a sale of the selling partner's undivided interest in each specific partnership asset.

The overwhelming weight of authority is contrary to the position heretofore taken by the Bureau, viz, that the sale of a partnership interest is a sale of the selling partner's undivided interest in each specific partnership asset. (See *Adam Kessler, Jr.* v. *United States,* 124 Fed. (2d) 152; *Commissioner* v. *Morris Shapiro,* 125 Fed. (2d) 532; *George H. Thornley et ux.* v. *Commissioner,* 147 Fed. (2d) 416; *Commissioner* v. *Estate of Daniel Gartling et al.,* 170 Fed. (2d) 73; *Commissioner* v. *Allan S. Lehman,* 165 Fed. (2d) 383, certiorari denied, 334 U.S. 819; *Commissioner* v. *H. R. Smith,* 173 Fed. (2d) 470, certiorari denied, October 10,

1949; *L. F. Long* v. *Commissioner,* 173 Fed. (2d) 471, certiorari denied, October 10, 1949; *Max Shapiro* v. *United States,* 83 Fed. Supp. 375; *contra: City Bank Farmers Trust Co. et al. (Housman Will)* v. *United States,* 47 Fed. Supp. 98.) See also *Robert E. Ford et al.* v. *Commissioner* (6 T.C. 499, acquiescence, C. B. 1946-2, 2) wherein the court (consistent with the views expressed in the above-cited cases that a partnership interest is a capital asset and that gain or loss realized upon the sale of such an interest is capital gain or loss) held that the basis for computing gain or loss on an asset purchased by a partnership and sold after the retirement of one of the partners was the original cost of such asset when acquired by the firm.

It is accordingly the opinion of this office that the sale of a partnership interest should be treated as the sale of a capital asset under the provisions of section 117 of the Internal Revenue Code. The application of this rule should, of course, be limited to those cases in which the transaction in substance and effect, as distinguished from form and appearance, is essentially the sale of a partnership interest. (See *Estate of Herbert B. Hatch et al.* v. *Commissioner,* 14 T.C. 251.) For example, payments made to a retiring partner which represent his distributive share of earnings for past services should be treated as ordinary income rather than the proceeds derived from a sale of his interest. (See *Helvering* v. *Heber Smith,* 90 Fed. (2d) 590; Ct. D. 1297, C.B. 1938-1, 277; *Richard S. Doyle* v. *Commissioner,* 102 Fed. (2d) 86; *James Wesley McAfee et ux.* v. *Commissioner,* 9 T.C. 720.) See also *Commissioner* v. *George Whitney et al.* (169

Fed. (2d) 562; Ct. D. 1719, C. B. 1949-1, 70, certiorari denied, 335 U.S. 892) wherein the court held that section 24 (b) (1) (B) of the Internal Revenue Code precluded the individual partners from deducting capital losses resulting from their sale of the partnership property to a corporation more than a majority of the stock of which was owned by them.

G.C.M. 10092 (C.B. XI-1, 114 (1932)) is hereby revoked. Other opinions of this office to the extent inconsistent with the view that a partnership interest is a capital asset are modified to conform herewith.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 416

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

MAX SWIREN,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

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RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI.

MAY IT PLEASE THE COURT:

Questions Presented.

The petitioner's statement of the questions presented is unacceptable. The questions presented are these:

1. Whether the amount received by respondent upon the sale of his partnership interest in excess of respondent's cost basis for such partnership interest was taxable to him as a capital gain or as ordinary income.

2. Whether the general rule that a partnership interest is a capital asset separate and distinct from the under-

lying partnership assets should be nullified by carving out for separate tax treatment certain underlying partnership assets.

Additional Statutes Involved.

In addition to the sections of the Internal Revenue Code included in the Appendix to the petition, Section 26 of the Illinois (Uniform) Partnership Act (Ill. Rev. Stats. (1949) c. 106½ §26) is involved. That section is as follows:

> §26—*Interest of Partner:* A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property.

Additional Statement.

In order adequately to present the undisputed facts surrounding the sale of respondent's partnership interest, it is necessary briefly to restate them.

By agreement dated December 13, 1944, the petitioner sold to Benjamin V. Becker and Don M. Peebles, the other two proprietary partners, for a cash consideration of $40,000, "all of his share and interest in the firm" excepting only his interest in one special situation.[1] Messrs. Becker and Peebles, by the same agreement, assumed all the liabilities and obligations of the firm, including a promissory note payable to the City National Bank and Trust Company for $17,500, a lease, and the participations of junior partners, and indemnified respondent against any firm liabilities or obligations (R. 83-84, 57-58).

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[1] As the Court of Appeals made clear (R. 99, fn.), the exclusion of this special item is irrelevant to the present issues, and respondent's tax treatment of that item was unchallenged either by the Commissioner or the Tax Court.

Respondent negotiated the sale of his partnership interest exclusively with Mr. Becker. The Tax Court expressly found that "in arriving at the sale price there was no agreement reached or discussion had" as to the value of any of the underlying assets or accounts of the partnership (R. 83).[2] This finding was accepted by the Court of Appeals (R. 99, 100). The negotiations between respondent and Mr. Becker were confined exclusively to a discussion of the value of respondent's partnership interest as a whole. Solely for his own purposes, and as an aid in determining for himself the value of his entire interest in the partnership, the respondent placed his own estimates of values upon the underlying assets of the firm (R. 67, 83, 35-39). Included among these underlying assets were accounts receivable, together with potential accounts receivable which would arise from work in process upon its completion but which were not ready for billing because the work had not been completed (R. 102).[3] Respondent in-

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[2] Petitioner incorrectly states the finding as follows: "In arriving at the sale price, there was no **explicit** agreement or discussion concerning the value of any of the underlying assets of the partnership" (Pet. 5). The express finding of the Tax Court leaves no room for the intended implication (R. 83).

[3] Although petitioner persists in labeling these assets "fees which had been earned but not yet billed or collected," the record makes perfectly clear that they constituted in the main potential accounts receivable for work in process, not yet completed or ready for billing (R. 35).

As the Court of Appeals put it (R. 102):

> "The Commissioner here attempts to segregate partnership accounts receivable and unbilled fees for work in process and arbitrarily label both past earnings.
>
> * * *
>
> "Uncollected fees for work in process not yet completed had not been transformed on the date of taxpayer's sale of his interest into gross income within the meaning of Section 183(b)(2), Internal Revenue Code."

formed Becker that he believed his interest in the partnership to be worth $45,000 to $50,000. Several days later, Mr. Becker offered respondent $40,000 for his interest, which offer was accepted (R. 99).

A supplementary agreement dated December 13, 1944, provided that all of respondent's interest in the income and expenses of the partnership terminated as at October 31, 1944 (R. 84-85, 99). Both the partnership and the taxpayer filed their tax returns upon a cash receipts basis (R. 100, 85). The net income of the partnership was $118,-708 for the taxable year in question (R. 85). These earnings consisted of the excess of collected fees over expenses actually paid (R. 76-77, 56). Respondent's distributive share of these earnings as at October 31, 1944, amounted to $29,917.26 (R. 85). Respondent returned and paid tax on his distributive share as ordinary income (R. 85, 100). Of the $40,000 that he was paid for his partnership interest, he reported $20,535.11 as capital gain. This was so much of the proceeds from the sale of his partnership interest as exceeded his cost basis (R. 85).

ARGUMENT.

I.

The decision below is in agreement with those of five other Courts of Appeals. There is no conflict.

The Court of Appeals determined that the gain from the sale of respondent's partnership interest was taxable as a capital gain.

In every circuit in which the nature of the gain or loss realized upon the sale of a partnership interest has been considered, the Court of Appeals has reached the precise result reached below. By now the Courts of Appeals for the Second, Fifth, Sixth, Seventh, Eighth and Ninth circuits have held that a sale of a partnership interest constitutes the sale of a capital asset regardless of the nature of the underlying assets. *McClellan* v. *Commissioner,* 117 F. (2d) 988 (C. A. 2d, 1941); *Commissioner* v. *H. R. Smith,* 173 F. (2d) 470 (C. A. 5th, 1949), *cert. den.* 338 U. S. 818 (1949); *Long* v. *Commissioner,* 173 F. (2d) 471 (C. A. 5th, 1949), *cert. den.* 338 U. S. 818 (1949); *First National Bank of Mobile* v. *Commissioner,* 183 F. (2d) 172 (C. A. 5th, 1950) (petition for certiorari pending, October Term 1950, No. 342); *Commissioner* v. *Shapiro,* 125 F. (2d) 532 (C. A. 6th, 1942); *Swiren* v. *Commissioner,* 183 F. (2d) 656 (C. A. 7th 1950); *United States* v. *Shapiro,* 178 F. (2d) 459 (C. A. 8th, 1949); *Stilgenbaur* v. *United States,* 115 F. (2d) 283 (C. A. 9th, 1940); *Commissioner* v. *Estate of Gartling,* 170 F. (2d) 73 (C. A. 9th, 1948).

There is no suggestion in the Commissioner's petition that any conflict has developed since 1949 when this Court denied certiorari in the *H. R. Smith* and *Long* cases, in both of which the Commissioner presented precisely the same questions as he presents here. All that has happened since then is that the Seventh and Eighth Circuits have

reached the same result. *United States* v. *Shapiro, supra; Swiren* v. *Commissioner.* And both before and after its decision in this case, the Tax Court has reached decisions identical to those of the Courts of Appeals. See *e.g. Estate of Jones* v. *Commissioner,* 3 T.C.M. 97 (1944); *Estate of Nitto* v. *Commissioner,* 13 T.C. 858 (1949) (reviewed by the entire Tax Court); *Luhrs* v. *Commissioner,* 9 T.C.M. 537 (1950).

Moreover, in all analogous situations, the Courts of Appeals and the Tax Court have treated a partnership interest as a capital asset under the tax laws. Thus, a partnership interest has a holding period and a cost basis of its own wholly separate from any of the underlying assets. *Commissioner* v. *Lehman,* 165 F. (2d) 383 (C. A. 2d, 1948), *cert. den.* 334 U. S. 819 (1948); *Thornley* v. *Commissioner,* 147 F. (2d) 416 (C. A. 3rd, 1945); *Ford* v. *Commissioner,* 6 T.C. 499 (1946) *acq.* 1946—2 C. B. 2; Section 113(a)(13), Internal Revenue Code. A deceased partner's interest in the partnership is a capital asset, the value of which is includable in his gross estate. *McClennen* v. *Commissioner,* 131 F. (2d) 165 (C. A. 1st, 1942). Partners purchasing a partnership interest from a selling partner acquire a capital asset and may not deduct the purchase price. *Hill* v. *Commissioner,* 38 F. (2d) 165 (C. A. 1st, 1930), *cert. den.* 281 U. S. 761 (1930); *Carter* v. *Commissioner,* 36 B.T.A. 60 (1937). And a partnership may have a taxable year separate and distinct from that of the individual partners, who realize taxable personal income, not as the income comes into the partnership, but at the conclusion of the partnership's taxable year. *Girard Trust Co.* v. *United States,* 182 F. (2d) 921 (C. A. 3rd, 1950); *Commissioner* v. *Estate of Mnookin,* 184 F. (2d) 89 (C. A. 8th, 1950).

To establish an asserted conflict, the petitioner relies upon the same three decisions that he relied upon when

unsuccessfully seeking certiorari in the *H. R. Smith* and *Long* cases, *supra.* In view of the subsequent agreement by additional Courts of Appeals, there is certainly no reason today to change this Court's 1949 determination that no such conflict existed as to warrant review.

The correctness of that determination is demonstrated by an examination of the three cases relied upon as establishing a conflict. (Pet. 13) *Helvering* v. *Smith,* 90 F. (2d) 590 (C. A. 2d, 1937), is plainly distinguishable in that there the Court of Appeals held, *first,* that there had actually been no sale of a partnership interest, and, *second,* that in any event, since the taxpayer had made no capital contribution and was entitled under the partnership agreement to receive only a proportionate share in earned fees, he had no partnership interest to sell. More significant, perhaps, is the fact, as the Court of Appeals below expressly recognized, that *Helvering* v. *Smith* has probably been overruled by *McClellan* v. *Commissioner,* 117 F. (2d) 988 (C. A. 2d, 1941) and *Williams* v. *McGowan,* 152 F. (2d) 570 (C. A. 2d, 1945).

Thus, in the latter case, Judge Learned Hand, who had written the opinion in *Helvering* v. *Smith,* stated that insofar as the *Smith* case had held that a partnership interest was not a capital asset, it had been overruled by the *McClellan* case, which had adopted the position taken by the Court of Appeals here. In the *Williams* case, the Court said (at 571):

> "It has been held that a partner's interest in a going firm is for tax purposes to be regarded as a 'capital asset.' *Stilgenbaur* v. *United States,* 9 Cir., 115 F. 2d 283; *Commissioner* v. *Shapiro,* 6 Cir., 125 F. 2d 532, 144 A.L.R. 349. We too accepted the doctrine in *McClellan* v. *Commisioner,* 2 Cir., 117 F. 2d 988, although we had held the opposite in *Helvering* v. *Smith,* 2 Cir., 90 F. 2d 590, 591. * * * "

In view of this specific discussion, it would take more than the inclusion of *Smith* with other decisions in a footnote to *Whitney* v. *Commissioner,* 169 F. (2d) 562, 567 (C.A. 2d, 1948) to resurrect *Smith* as authority on the question here involved.

The Court of Appeals recognized that *Doyle* v. *Commissioner,* 102 F. (2d) 86 (C. A. 4th, 1939) was not in conflict but was inapplicable to the facts in this case (R. 103). In *Doyle,* the taxpayer, after dissolution, sold his interest in a specific fee to one of his former partners and was taxed thereon at ordinary rates. There was no claim that a partnership interest had been sold.

Finally, petitioner points to *City Bank Farmers Trust Co.* v. *United States,* 47 F. Supp. 98 (Ct. Cls. 1942), which held that the holding period of a partnership interest must be determined by reference to the holding periods of the individual partnership assets. Since the case on its facts is not in point, the petitioner presumably regards the implications of the decision as being in conflict with the decision below. The *City Bank* case has never been followed and in *Commissioner* v. *Lehman,* 165 F. (2d) 383 (C. A. 2d, 1948), a case on all fours with the *City Bank* case, it was expressly repudiated. Nevertheless, this Court denied certiorari in the *Lehman case,* 334 U. S. 819 (1948). If this Court did not regard the conflict between *Lehman* and *City Bank* as then warranting review, it is difficult to see how the *City Bank* case can now provide such a conflict with the instant case as to warrant the granting of certiorari.

The petitioner candidly concedes that the present petition, together with his acquiescence in the taxpayer's petition in the *First National Bank of Mobile* case, No. 342, is an attempt on the part of the Commissioner to have this Court reconsider the same questions presented to it in the petitions for certiorari in *Commissioner* v. *Lehman,*

cert. den. 334 U. S. 819 (1948), in *Commisioner* v. *H. R. Smith, cert. den.* 338 U. S. 818 (1949), and in *Commissioner* v. *Long, cert. den.* 338 U. S. 818 (1949). (Pet. 12, fn.)[4] If the Commissioner thinks the situation warrants it, he may apply to Congress for relief, rather than repeatedly asking this Court to reconsider the same question in the absence of any disagreement among the Courts of Appeals.

II.

There is no conflict between the opinion below and G.C.M. 26379, but if there were, it would be immaterial.

The Commissioner also asserts that this Court should review the decision below, *first,* because the decision is in conflict with a recent General Counsel's Memorandum, and, *second,* because the asserted conflict illustrates that the Commissioner by unilateral action is unable to put an end to litigation.

Dealing with the second ground first, it seems clear that positions taken in a General Counsel's Memorandum are not to be accorded any greater weight than positions taken by the Commissioner in litigation or through Regulations. A taxpayer is always free to disagree with any position taken by the Commissioner, no matter what the form of expression, and if this were a basis for certiorari, we respectfully suggest that this Court's entire calendar would consist of federal tax questions.

We fail to see why the uniform decisions of six Courts of Appeals do not import such finality into the law as to relieve this Court of any further responsibility for review. And certainly the Commissioner's suggestion that

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[4] Although not cited either by the Court of Appeals for the Fifth Circuit, or by the Commissioner in his answer to the petition for certiorari in the First National Bank of Mobile case, No. 342, Commissioner v. Lehman, 165 F. (2d) 383 (C..A. 2d, 1948), cert. den. 334 U. S. 819 (1948), decided the same issues and is in complete accord with the position taken by the Court in that case.

otherwise litigation might continue until all ten Courts of Appeals have reached the same result, cannot be seriously advanced as a basis for the issuance of a writ of certiorari.

It is not accurate to say, as the Commissioner does, that the Court below "ignored" the exceptive provision of G.C.M. 26379 (Pet. 10). The Court considered the entire G.C.M., (R. 100), and plainly found the exceptive provision inapplicable by its terms. The G.C.M. abandoned the prior position of the Bureau and acquiesced in the "overwhelming weight of authority" that a partnership interest is a capital asset. The exceptive provision upon which the Commissioner relies was intended to limit the newly adopted position to those cases where the transaction was substantive and genuine, rather than fictitious and formal. Thus, the exceptive provision states:

> "The application of this rule should, of course, be limited to those cases in which the transaction in substance and effect, as distinguished from form and appearance, is essentially the sale of a partnership interest." (Pet. 31.)

But both the Tax Court and the Court of Appeals determined that this was in substance and in fact the sale by the respondent of his entire partnership interest (R. 83-85, 99, 100).

Moreover, the example given in G.C.M. 26379 of when the general rule will not be followed has no application here. The G.C.M. goes on to say:

> "For example, payments made to a retiring partner which represent his distributive share of earnings for past services should be treated as ordinary income rather than the proceeds derived from a sale of his interest." (Pet. 31.)

We take no exception to that statement. The respondent returned as ordinary income his distributive share of the partnership earnings, and both the Tax Court and the

Court of Appeals so found (R. 85, 100, 102). Neither the petitioner nor the Tax Court has suggested that taxpayer's partnership did not compute its income (and hence the taxpayer's distributive share) except in precise accordance with the applicable statutory provisions. Section 182(c), Section 183(b)(2) Internal Revenue Code. (Pet. 25, 26.)

But petitioner asserts that accounts receivable, together with potential accounts receivable from work in process not yet ripe for billing or collection, were properly a part of the respondent's "distributive share of partnership earnings" and therefore not a part of his partnership interest. This argument has been unsuccessfully advanced by petitioner in nearly every one of the cases decided by the Courts of Appeals and noted above. See *e.g.*, petitions for certiorari in *Commissioner* v. *H. R. Smith*, October Term, 1949, No. 120, *cert. den.* 338 U. S. 818 (1949); *Commissioner* v. *Long*, October Term, 1949, No. 121, *cert. den.* 338 U. S. 818 (1949). It is in conflict with the precise provisions of Sections 182(c) and 183(b)(2) of the Code. The opinion of the Court below disposes completely of the Commissioner's argument. As the Court said (R. 102):

> "The Commissioner here attempts to segregate partnership accounts receivable and unbilled fees for work in process and arbitrarily label both past earnings. The Commissioner argues that fees billed but uncollected, together with potential fees for work in process but not ready for billing or collection were taxpayer's 'distributive share of partnership earnings' and therefore not a part of his partnership interest. We cannot agree.
>
> "When taxpayer purchased his interest in the firm he became entitled to his proportionate share of all fees collected by such partnership, and a portion of such fees had on the date of his purchase been billed but uncollected and other fees were for work then in process. Such fees when collected were ordinary

otherwise litigation might continue until all ten Courts of Appeals have reached the same result, cannot be seriously advanced as a basis for the issuance of a writ of certiorari.

It is not accurate to say, as the Commissioner does, that the Court below "ignored" the exceptive provision of G.C.M. 26379 (Pet. 10). The Court considered the entire G.C.M., (R. 100), and plainly found the exceptive provision inapplicable by its terms. The G.C.M. abandoned the prior position of the Bureau and acquiesced in the "overwhelming weight of authority" that a partnership interest is a capital asset. The exceptive provision upon which the Commissioner relies was intended to limit the newly adopted position to those cases where the transaction was substantive and genuine, rather than fictitious and formal. Thus, the exceptive provision states:

> "The application of this rule should, of course, be limited to those cases in which the transaction in substance and effect, as distinguished from form and appearance, is essentially the sale of a partnership interest." (Pet. 31.)

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income and those receiving them, including taxpayer, paid a tax thereon for ordinary income.

"Taxpayer was on a cash receipts basis, as was the partnership. Uncollected fees for work in process not yet completed had not been transformed on the date of taxpayer's sale of his interest into gross income within the meaning of Sec. 183(b)(2), Internal Revenue Code.

"In various of the cases heretofore cited, listed among the partnership assets were such items as accounts receivable, rents receivable and unfinished work which in due course would yield gross income to the partnership. Nevertheless the various Courts of Appeals and also the Tax Court treated the partnership interest as a whole, without regard to the nature of the underlying assets, and held the interest to be a capital asset."

To hold otherwise than did the Court of Appeals would be to hold that upon the sale of a partnership interest there is also separately sold certain underlying assets of a non-capital nature which are somehow carved out or separated from the partnership interest for separate treatment. As all of the Courts of Appeals have recognized, such a treatment is inconsistent with the nature of a partnership interest. Under the applicable section of the Illinois (Uniform) Parnership Act and all of the authorities, a partnership interest consists of the surplus of the assets over the liabilities, and a partner has no individual interest in any particular asset. This alone is enough to make inapplicable those cases relied upon by petitioner, that render ineffective the commutation of rights to future payments or the anticipatory assignment of future income. (Pet. 16-18)

Although in the Court of Appeals petitioner conceded that Illinois law controlled the determination of the nature of respondent's partnership interest, he now contends that the asserted error of the Court of Appeals was the

result of its reliance on Illinois law. (Pet. 18-19).[5] The petitioner's reversal of position here is undoubtedly an attempt to avoid the near finality which this Court gives to determinations of local law questions by the Courts of Appeals. *Spiegel's Estate* v. *Commissioner,* 335 U. S. 701 (1949); *Helvering* v. *Stuart,* 317 U. S. 154 (1942). The nature of respondent's partnership interest was governed by Illinois law. *Commissioner* v. *Lehman,* 165 F. (2d) 383 (C.A. 2d, 1948); *cert. den.* 334 U. S. 819 (1948); *Commissioner* v. *Smith,* 173 F. (2d) 470 (C.A. 5th, 1949), *cert. den.* 338 U. S. 818 (1949). And the Court of Appeals in the present case correctly determined that under Illinois law a partnership interest was a species of property wholly separate and distinct from the underlying assets. Illinois (Uniform) Partnership Act, Ill. Rev. Stats. (1949) c. 106½ § 26; *Lindley* v. *Murphy,* 387 Ill. 506, 513-514 (1944); *Lueth* v. *Goodknecht,* 345 Ill. 197, 199-200 (1931).

But even if the question be regarded as a federal question under the Revenue Act, the same result would be reached. In adopting the Revenue Act, Congress was aware of the fact that under all of the decisions dealing with the question, the partnership interest was held to be distinct and separate from the underlying partnership assets. See, *e. g. Blodgett* v. *Silberman,* 277 U. S. 1 (1928) (construing the New York (Uniform) Partnership Act), and *Case* v. *Beauregard,* 99 U. S. 119 (1878) (nature of partnership interest prior to the Uniform Partnership Act). *Cf. United States* v. *Kaufman,* 267 U. S. 408 (1925). The acquiescence by Congress in the local law is shown by Section 113(a)(13) of the Internal Revenue Code

[5] Petitioner argued the Illinois law at length in the Court of Appeals, and at page 24 of his brief said this: "State law is often controlling as to the nature of a property interest and may be deemed to be so here."

which makes clear that a partnership interest is a capital asset with a cost basis of its own.

This Section deals with the basis of property acquired by a partnership and the basis of the partnership property after it has been distributed in kind to a partner. The Section, to the extent relevant, provides:

> "If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner *shall be such part of the basis in his hands of his partnership interest* as is properly allocable to such property." (Emphasis supplied.)

It must be apparent that if there were no distinction between a partnership interest and the underlying assets, it would be unnecessary to provide a substituted basis when the underlying asset is distributed in kind to the individual partners.

In the Section just quoted, Congress provided for a substituted basis in recognition that a partnership interest is a distinct type of property. It is, therefore, a capital asset within the meaning of Section 117(a)(1), Internal Revenue Code. (Pet. 23.) The Court of Appeals in the *First National Bank of Mobile* case expressly recognized that this was the correct meaning to be ascribed to the inclusion of Section 113(a)(13). 183 F. (2d) at 173. For a full discussion, see *Brooks, The Strange Nature of the Partnership Under the Income Tax Law,* 5 Tax L. Rev. 35, 41 (1949).

III.

The question presented is of no importance to the revenue.

The determination of the questions presented does not affect the revenue. As the Commissioner concedes, the question presents "an arguable issue whose resolution either way sometimes redounds to the benefit of the tax-

payer and sometimes to the benefit of the Government." (Pet. 9.) This is well illustrated by the fact that the taxpayer petitioned for certiorari in the *First National Bank of Mobile,* case No. 342, while the Commissioner is the petitioner in the instant case, although the results reached by the Courts of Appeals for the Fifth and Seventh Circuits were completely harmonious. Even in this very case the revenues are not adversely affected. Respondent reported a capital gain upon his sale of his partnership interest. In addition, as the underlying partnership assets ripen into taxable income in the hands of the continuing partners, it will be taxable to them at ordinary rates. *Hill* v. *Commissioner,* 38 F. (2d) 165 (C.A. 1st, 1930), *cert. den.* 281 U. S. 761 (1930); *Carter* v. *Commissioner,* 36 B.T.A. 60 (1937).

CONCLUSION.

The Courts of Appeals for six Circuits are in agreement on the question presented and this Court has refused to review the same issue on three prior occasions. The subsequent agreement by additional circuits only strengthens the prior determination of this Court that the question presented is not appropriate for review. There is no danger to the revenue since the result reached operates sometimes in favor of the Government and sometimes in favor of the taxpayer.

For the reasons heretofore assigned, the petition for writ of certiorari should be denied.

Respectfully submitted,

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December 8, 1950.